VZCZCXRO3264
PP RUEHCHI RUEHFK RUEHHM RUEHKSO RUEHNAG RUEHPB RUEHRN
DE RUEHNZ #0011/01 0772224
ZNR UUUUU ZZH
P R 182224Z MAR 09
FM AMCONSUL AUCKLAND
TO RUEHC/SECSTATE WASHDC PRIORITY 0566
INFO RUEATRS/DEPT OF TREASURY WASHINGTON DC
RHEHAAA/NATIONAL SECURITY COUNCIL WASHINGTON DC
RUEHSS/OECD POSTS COLLECTIVE
RUEHZU/ASIAN PACIFIC ECONOMIC COOPERATION COLLECTIVE
RUEHNZ/AMCONSUL AUCKLAND 0794

UNCLAS SECTION 01 OF 03 AUCKLAND 000011

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: EFIN ECON PGOV NZ
SUBJECT: (U) NEW ZEALAND - AUCKLAND BANKERS KEEP THEIR FINGERS
CROSSED

REF: 08 WELLINGTON 336

AUCKLAND 00000011 001.2 OF 003

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¶1. (SBU) Summary. New Zealand's conservative banks have so far weathered the local recession and global financial crisis well. Delinquencies are up but remain manageable. Traditionally dependent on global money markets for much of their financing, local banks have managed to get the cash they need from their Australian parents and local depositors. There are clouds on the horizon, however, including fears that unemployment may yet increase significantly and complaints from the business sector that the banks have become too stingy. End summary.

New Zealand's Dull Banks

¶2. (SBU) New Zealand's banking sector is dominated by four large institutions, all subsidiaries of Australian banks, which control over 90% of the NZ banking sector's assets. Under NZ law, the local institutions must operate as separate banks, rather than as branches of their Australian parents. As noted in ref A, the NZ banks are conservative institutions. The sub-prime mortgages that poisoned the U.S. financial system do not exist in New Zealand. Also, NZ banks rarely securitize their own assets; they tend to carry loans on their books until paid off. NZ bank portfolios are divided roughly evenly between residential mortgages and commercial loans. The New Zealand Institute recently noted that there are only thirteen large banks worldwide that still carry a AA rating, among them are all four parents of New Zealand's Big Four banks.

Finding Funds in an Unfriendly Market

¶3. (SBU) While not vulnerable because of sloppy lending, NZ banks remain at risk from the crippling of global credit markets. As of November, NZ banks sourced 40% of their funding from offshore, but that money is harder to come by. Like the Australian Government, the GNZ has offered to guarantee loans to NZ banks from overseas lenders (the "wholesale guarantee"). It's not clear how useful the guarantee will be. Only one bank has taken advantage of it to date.

¶4. (SBU) If the wholesale guarantee is not bringing in funds, how are NZ's banks finding cash? Mostly they are being funded by their Australian parent banks, within limits imposed by Australian bank regulators. As they bump up against these limits, the Australian parents are opening separate NZ branches (which they can fund without restriction). They are also taking advantage of a new Reserve Bank program that buys mortgages from the banks. At least one is borrowing short-term on international markets without a guarantee and at a premium. One local banker reports that, contrary to the common assumption, there is still private equity money available (mostly from the U.S.). However, long-term money remains difficult to come by, and is very expensive. Most institutions are taking only short-term money.

¶5. (SBU) Banks are also battling each other for retail deposits. The pool of retail deposits looking for a home has grown because of the collapse of many New Zealand finance companies, non-bank deposit-takers that went under last year after a few high-profile failures led to a run on the sector. Retail depositors who once chased slightly higher returns at the finance companies are now bringing their money to the banks. However, like the offshore funding, these retail deposits are volatile, going into demand accounts rather than term accounts.

Fewer Customers Looking for Loans

¶6. (SBU) Bankers claim that demand for credit is falling, and Reserve Bank figures confirm that lending is down. Lending to households dropped dramatically in 2008 as the housing market slumped; lending to business fell at the same time, if less steeply. Only lending to the agriculture sector went up. Representatives of a number of local banks have told the CG that their institutions are only lending to current clients and are not seeking new business.

Unpopular Bankers

¶7. (SBU) If banks are reluctant to lend, they have justification. Delinquencies and defaults are up. ANZ, the biggest in the New Zealand market, recently announced a 25% dividend cut and said its provision for bad debt could double this year. Westpac announced that delinquencies in its NZ mortgage portfolio increased 40% in the last quarter of 2008. An executive with one of the large banks shared figures that

show delinquencies in mortgages, personal loans, and credit cards continued to increase significantly in January.

¶8. (SBU) While it is prudent for bankers to be more cautious when the economy slows, they are starting to feel the heat from their business clients. NZ banks remain very profitable, and local businesses think the banks should be more generous. Borrowers claim that what the banks describe as a declining demand for lending is actually credit rationing. One consultant told the CG that banks are reducing lending to even blue chip customers. Companies complain of new covenants and other hurdles. They further complain that cuts in the Reserve Bank's Official Cash Rate are not being passed on to borrowers. Even Reserve Bank Governor Bollard felt obliged to publicly warn the bankers of the "corporate anger" they face. Bankers respond that they need to consider loan applications more carefully in the current market. One banker noted that long-time commercial clients who previously were able to renew credit after providing only cursory financial information are now being pressed for more detailed business plans.

¶9. (SBU) Less lending by banks, for whatever reason, and the evaporation of the commercial paper market have prompted a number of companies to make public bond offerings. These are particularly useful to big names like Fonterra and Fletcher Building and buyers who used to be customers of the finance companies. The sellers get a source of cash outside the banking system, and the buyers get a return higher than that offered on ordinary bank deposits. But the bond option is available only to strongest firms. While the Fonterra and Fletcher offerings were oversubscribed, troubled white goods maker Fisher and Paykel had to pull a planned offering.

Other Institutions

¶10. (SBU) The local branches of big multinational financial institutions have a different set of complaints. The name recognition of Citi, HSBC, and AIG, once a source of strength and the cornerstone of their marketing, is now a source of

headaches. Representatives of those institutions now must assure potential clients that, regardless of the problems at head office, their NZ operations are doing just fine. The operations of all three are relatively small. Neither Citi nor HSBC have any significant retail or lending operations. Citi does investment banking and international work. HSBC does the same, as well as some personal banking for high-income clients. AIG mostly sells ordinary life insurance in programs for groups like the NZ Police. All report they are making profits.

Comment: Looking Ahead Warily

¶11. (SBU) Overall, our contacts in the financial sector expressed confidence in the durability of the sector, and of the wider New Zealand economy. One banker pointed out that the NZ

economy has been in recession for over a year. But the pace and depth of that recession have both been moderate so far, and businesses in NZ have had more time to adapt than counterparts in economies that crashed suddenly. Also, while delinquencies and defaults are up and credit is harder to come by, conditions resemble a conventional downturn rather than a meltdown. One banker noted that the problems in his bank's mortgage portfolio are so far limited to borrowers who "stretched" - borrowers who depended on two incomes but now have only one, foreign borrowers whose source of income abroad has shrunk, etc. The average family with the average house and average mortgage, this banker said, is still paying on time.

¶12. (SBU) New Zealand's small size, isolation, and unimaginative bankers - all factors considered negatives a couple of years ago - are now seen as virtues. The banks are well-provisioned against bad loans. Even the Reserve Bank's worst case scenario - housing prices down 30%, unemployment up to 9%, and interest rates up 300 basis points - "would still not lead to delinquencies and banking sector stress on the scale being seen in the U.S." Since that scenario was described in November, interest rates have fallen, housing prices have gone down only modestly, and unemployment has only edged upwards, to 4.6%. As one banker put it, "we are approaching the 2001 NZ downturn levels, but nowhere near (yet!) the 1991 levels" (when unemployment in NZ surpassed 10%).

¶13. (SBU) That "yet!" should not be overlooked. While stressing that the current economic situation is merely poor, rather than apocalyptic, Auckland's bankers expressed concern about the coming months. All of our contacts wonder whether NZ has yet to see the full impact of the global economic downturn. The banker who compared the current situation to the relatively mild 2001 recession cautioned that delinquency rates are beginning to rise and expressed concern about potential for growing unemployment. Another noted that having half of its eggs in the mortgage basket is a potential vulnerability for NZ's banking sector. If unemployment continues to rise, mortgage problems could spread to ordinary homeowners, and NZ's undiversified banks will have few other revenue streams to fall back on.

¶14. (SBU) Yet another banker pointed to lending to the agricultural sector, which continued to grow last year even as residential and commercial lending fell. When dairy prices skyrocketed over the past few years, the sector grew quickly, fueled by credit. Dairy prices have since returned to normal, and many farmers remain highly leveraged. Finally, another banker reported that he's fielding a growing number of calls from corporate clients looking to renew credit falling due in a few months. They are examining their revenue projections and finding they won't be in a position to meet the terms of their loans. They're calling their banker now in hopes of getting ahead of the problem before their loans fall due in a few months. Indeed, all of our contacts agreed that the next few months will determine whether the NZ economy remains in a manageable recession or suffers a more serious downturn.
DESROCHER